

BEFORE THE INVESTOR PROTECTION DIRECTOR **SEP 13 2018**
FOR THE STATE OF DELAWARE

In the matter of)
) **Case No. 18-0027**
LPL FINANCIAL LLC,)
)
Respondent.) **ADMINISTRATIVE CONSENT ORDER**
)

WHEREAS, LPL Financial LLC ("LPL") is a broker-dealer with a principal place of business at 75 State Street, 22nd Floor, Boston, MA 02109, that is registered in the state of Delaware; and

WHEREAS, a coordinated investigation into LPL's failure to establish and maintain reasonable policies and procedures to prevent the sale of unregistered, non-exempt securities by LPL to its customers, including LPL's retention, use, and subsequent cancellation of certain third-party services integral to LPL's compliance with state securities registration requirements (a/k/a "Blue Sky" laws); and certain other deficiencies within LPL's compliance structure related to LPL's controls, monitoring and reporting tools, and escalation protocols in relation to LPL's response to significant compliance issues resulting from such failure during the period of approximately October 1, 2006 through May 1, 2018 (the "Investigation") has been conducted by a multistate task force, coordinated among members of the North American Securities Administrators Association ("NASAA"), with Massachusetts and Alabama serving as the "Lead States"; and

WHEREAS, LPL has agreed to resolve the Investigation, upon the terms specified in the Settlement Term Sheet executed as of May 1, 2018 between LPL and the Lead States on behalf of participating NASAA jurisdictions, with all participating states and territories identified in Appendix A to the Settlement Term Sheet (each, a "Jurisdiction" and collectively, the "Jurisdictions"); and

WHEREAS, LPL agrees to comply in all material respects with the undertakings specified herein; and

WHEREAS, LPL elects to permanently waive any right to a hearing and appeal under 6 Del. C. §§ 73-304, 73-502, 73-601 with respect to this Administrative Consent Order (the "Order");

NOW, THEREFORE, the Investor Protection Director for the State of Delaware (the "Director"), as administrator of the Delaware Securities Act (6 Del. C. Ch. 73) (the "Act"), hereby enters this Order:

1. LPL admits the jurisdiction of the Investor Protection Unit ("IPU") of the Delaware Department of Justice, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order, and consents to the entry of this Order by the IPU.

I. FINDINGS OF FACT

A. BACKGROUND, CONTRACT WITH BSDC

2. Every broker-dealer is required to have a supervisory system that is reasonably designed to ensure that the broker-dealer complies with all state and federal laws, rules and regulations, including laws that prohibit the offer or sale of unregistered, non-exempt securities. Securities issued by companies listed on major national exchanges (*e.g.*, NYSE, AMEX, NASDAQ) and securities issued by registered investment companies (*e.g.*, mutual funds) are in most instances exempt from the Blue Sky requirements at issue here.
3. A reasonably designed system at a minimum includes written policies and procedures governing the offer and sale of securities by registered persons, training for all associated persons, and supervisory procedures and designated supervisors responsible for ensuring compliance.
4. In January 2000, LPL entered into an agreement with Blue Sky Data Corporation ("BSDC"), by which BSDC was obligated to supply LPL with data for LPL's use in compliance and supervisory efforts related to Blue Sky laws, rules, and regulations (the "Subscription Agreement"). The Subscription Agreement was amended in 2006.
5. As executed in January 2000 and amended in mid-2006, the Subscription Agreement included data for equity securities, but not for fixed income securities.
6. From at least January 2000 forward, the Subscription Agreement provided for a data feed that, if properly utilized, would allow for the review of trades to ensure that equity

securities were properly registered in the customer's state. The subscription also provided online access for authorized personnel to query a specific CUSIP to determine its registration status in each U.S. state and territory. As described in more detail below, although the contract would enable such review, LPL failed to ensure during the relevant period that the data was comprehensively utilized and that its systems were properly configured to effectively make use of the data.

B. BLUE SKY COMPLIANCE EFFORTS

7. LPL has represented that for a number of years, through at least October 2006, LPL's Surveillance Department conducted a manual review of certain solicited equities trades to confirm Blue Sky compliance. This involved the use of various reports and reference to registration and exemption data from BSDC, as a result of the state securities registration subscription described above, and resulted in LPL identifying certain violations and taking certain remedial actions.
8. At some point after October 2006 the manual Blue Sky Review process described above lapsed. Records reflect that LPL thereafter failed to meet Blue Sky compliance obligations and failed to address registration and exemption requirements in the states.
9. Records reflect that in 2006, LPL supplemented its subscription with BSDC to, among other things, include automated checks (a/k/a "edits") to review orders against data from BSDC. Records reflect that the Subscription Agreement was amended based on an assumption by certain LPL personnel that, with this supplemental data feed feature, a front-end order entry block (*i.e.*, an automated mechanism that would prevent the execution of trades of unregistered, non-exempt securities) could be implemented with a fair degree of ease.
10. Lacking necessary training, supervision and process implementation of various order entry systems, including the role of both proprietary systems and vended, third-party systems, LPL personnel failed to accomplish the additional steps that would be required to implement a front-end order entry hard block. While it appears from LPL records that the implementation difficulties were recognized by certain personnel and some efforts to resolve the technological obstacles were undertaken over a period of time, these efforts

were not successful as the efforts were not given the appropriate stature within LPL, necessary training, or appropriate and adequate supervision.

11. As reflected in various records, poor intradepartmental and interdepartmental communications and a lack of integrated supervision and governance over vendor agreements, order entry systems controls, and Blue Sky compliance contributed to the failure of certain personnel in both Trading and Compliance to recognize at various points in time that Blue Sky hard blocks had not been implemented into LPL's order entry systems.
12. Records reflect that, during the relevant period, other personnel appeared to place reliance on other surveillance reviews that were designed for purposes of complying with certain LPL internal policies (for example, surveillance reviews pertaining to compliance with LPL's internal prohibition of solicited trades of low-priced and certain unlisted securities) as a means of capturing Blue Sky violations. LPL failed to ensure there was a review specifically designed to address state securities registration requirements.
13. The groups and functions that are required for ensuring Blue Sky compliance were not integrated and were fragmented across the organization, particularly in a period during which LPL was experiencing significant growth. Moreover, LPL lacked and failed to provide institutional Blue Sky expertise or experience in the form of an individual or individuals with particularized knowledge of industry-wide standards, policies, procedures and processes. This resulted in a failure by LPL to comprehensively address Blue Sky compliance needs and to develop and fund what should have been a centralized set of Blue Sky compliance controls.

C. CANCELLATION AND REINSTATEMENT OF BSDC DATA FEED

14. In or around January 2014, LPL's Procurement Department ("Procurement") undertook a review of various vendor contracts. Procurement identified the Subscription Agreement, at a cost of \$31,200 per year, and inquired whether LPL had a need for the service and who within LPL used the subscription. The purpose of this inquiry was to determine whether Procurement could cancel or not renew the BSDC subscription.

15. Procurement was directed to LPL's Governance, Risk & Compliance Department ("Compliance"), specifically a vice president in Compliance ("VP Compliance").
16. Without adequate controls in place to ensure that the inquiry was conducted properly, VP Compliance and an assistant vice president in Compliance sent a series of separate emails to various personnel within LPL's Registrations, Trading, Compliance, and Operations departments to determine whether LPL had a continued need for the BSDC subscription or whether the contract could be cancelled.
17. None of the personnel consulted indicated that the BSDC subscription was critical to compliance with Blue Sky state registration requirements.
18. Following these inquiries, in February 2014, VP Compliance wrote to Procurement that it was "ok to discontinue" LPL's subscription to the Subscription Agreement.
19. In March 2014, Procurement provided written notice to BSDC to terminate the Subscription Agreement and LPL paid the final April 2014 invoice.
20. Email records reflect that on October 23, 2014, a trader on LPL's Equity Trading desk ("Equity Trading") reviewed a screen that contained information showing a particular security to be restricted as a result of not being registered for sale or exempt from registration in the particular jurisdiction (which information appears to have been populated to the system before the BSDC contract was terminated). The trader shared the screen with a Manager in Equity Trading who in turn contacted BSDC in an effort to determine whether the particular restriction was valid. Through this outreach to BSDC, that Manager learned that LPL's subscription to the state securities registration data had been cancelled months earlier.
21. On October 24, 2014, Equity Trading requested by email that the subscription be immediately reinstated. In that email, Equity Trading explained that it relied on the data to determine if over-the-counter securities are Blue Sky-compliant in the U.S. and territories, stating: "[w]e would like to request to have this subscription renewed as quickly as possible as this is a critical part of our day to day business."
22. In December 2014, LPL and BSDC reinstated the Subscription Agreement and in February 2015, LPL was again receiving up-to-date data into its equity trading system from BSDC.

23. Both before and after the contract cancellation, alerts relating to potential Blue Sky registration violations for equity securities were visible only to the trading desk and not to financial advisors who placed trades directly and, as noted above, notwithstanding that LPL had access to BSDC data for equity securities, LPL's systems did not operate to prevent a trade that was not Blue Sky-compliant (*i.e.*, a front-end block).
24. While the reinstated Subscription Agreement obligated BSDC to provide LPL with data for both equity and fixed income securities, at no point prior to December 2014 did the Subscription Agreement include data for fixed income securities.

D. POST-REINSTATEMENT REVIEW AND REMEDIAL MEASURES

25. Following the reinstatement of the BSDC contract, LPL conducted a review of certain equities and fixed income trades and identified certain Blue Sky violations requiring remediation. LPL attempted repurchase or damages offers to affected investors identified through this limited review. In connection with the making of these offers, LPL contacted securities regulators in certain jurisdictions about the offers.
26. As reflected in various records, poor intradepartmental and interdepartmental communications and a lack of integrated supervision and governance resulted in LPL's failure at that time to conduct a sufficient analysis to determine the root cause of the identified violations and compliance and supervisory shortcomings.
27. LPL has represented that following the reestablishment of the BSDC contract, LPL implemented several Blue Sky controls.
28. LPL has engaged several consultants to conduct a comprehensive review of its current Blue Sky compliance program and to assist LPL with implementation of recommendations, which is ongoing.
29. LPL has represented that it has designed and began implementing Blue Sky training for Compliance, Trading, Operations and Legal personnel and hired a senior-level Blue Sky compliance expert as a full-time employee, who has responsibilities for establishing and implementing the enhanced Blue Sky compliance program as guided by the independent consultants.

II. CONCLUSIONS OF LAW

1. The IPU has jurisdiction over this matter pursuant to §73-501 of the Act.
2. LPL failed to invest sufficient and appropriate resources in personnel, expertise, systems, and operations to adequately comply with Blue Sky laws, rules, and regulations, in violation of §73-304(a)(10).
3. LPL failed to reasonably supervise the flow of information to ensure full and proper compliance with state securities registration requirements, in violation of §73-304(a)(10).
4. LPL failed to maintain adequate systems to reasonably supervise agents, staff, and employees, in violation of §73-304(a)(10).
5. LPL failed to supervise agents, staff, and employees in the performance of duties with respect to systems operation, process, and checks and balances to ensure compliance with Blue Sky laws, rules, and regulations, in violation of §73-304(a)(10).
6. LPL acted negligently in canceling certain third-party services critical for compliance with Blue Sky laws, rules, and regulations, in violation of §73-304(a)(10).
7. LPL failed to maintain books and records necessary to ensure full and proper compliance with Blue Sky laws, rules, and regulations, in violation of §73-303(a) of the Act and Rule 706 of the Rules Pursuant to the Act.
8. LPL failed to conduct appropriate and necessary due diligence regarding the retention, use, and subsequent cancellation of certain third-party services critical for compliance with Blue Sky laws, rules, and regulations, in violation of §73-304(a)(10) and §73-303(a) of the Act and Rule 706 of the Rules Pursuant to the Act.
9. The following relief is appropriate and in the public interest.

III. ORDER

On the basis of the Findings of Fact, Conclusions of Law, and LPL's consent to the entry of this Order,

IT IS HEREBY ORDERED:

1. This Order concludes the Investigation and any other action that the IPU could commence under applicable Delaware law on behalf of Delaware as it relates to the substance of the Findings of Fact and Conclusions of Law herein, provided however, that excluded from and not covered by this paragraph 1 are any claims by the IPU arising from or relating to LPL's failure to comply with the undertakings contained herein.
2. This Order is entered into solely for the purpose of resolving the referenced multistate investigation, and is not intended to be used for any other purpose.
3. LPL shall CEASE AND DESIST from violating §73-303(a) and §73-304(a)(10) of the Act and Rule 706 of the Rules Pursuant to the Act and will comply with §73-303(a) and §73-304(a)(10) of the Act and Rule 706 of the Rules Pursuant to the Act.

A. PENALTY

4. LPL Financial Holdings Inc., or its direct or indirect subsidiaries, shall, within 14 calendar days of the date of the mailing of the executed copy of this Administrative Consent Order by the IPU, pay the sum of \$499,000.00 to the "State of Delaware – Investor Protection Fund." The monies received by the IPU pursuant to this paragraph may be used, in accordance with Delaware law, to reimburse the IPU for costs incurred during the investigation of this matter, for securities and investor education, and/or for other securities and investor protection purposes, at the discretion of the Director. The check shall be made payable to the "State of Delaware."

B. CUSTOMER REMEDIATION

5. No later than July 2, 2018, LPL shall commence a comprehensive review of all customer transactions effected in Delaware to assess compliance with all applicable state securities registration requirements ("Historical Trade Review").
6. The Historical Trade Review shall include all executed, solicited (excluding non-issuer transactions) purchase orders of equity and fixed income securities effected in Delaware between October 1, 2006 (insofar as LPL and/or any third party, vendor, supplier or service has necessary records) and May 1, 2018 (the "Historical Trade Review Period").
7. For the purposes of the Historical Trade Review, a transaction shall be deemed to have been effected in Delaware if the customer's address of record (or the address of record for

the beneficial owner of any account, as applicable) at the time of the transaction was within Delaware.

8. The Historical Trade Review shall be conducted by an unaffiliated third party that is not unacceptable to the Lead States (the "Independent Reviewer"). The Independent Reviewer shall not be a person or entity who has provided LPL with any products or services related to Blue Sky compliance prior to July 1, 2017.
 - a. In conducting the Historical Trade Review, the Independent Reviewer may rely on historical research, data, and other services provided by a third-party service provider other than the Independent Reviewer. The Independent Reviewer may further rely on any determination by such a third-party service provider that a particular trade complied with state registration requirements.
 - b. Upon request, LPL shall provide the IPU with copies of all final contracts and directives related to the engagement of the Independent Reviewer and any other third-party service provider involved in the Historical Trade Review and the related remediation. LPL shall promptly respond to any additional requests for information by the IPU relating to such engagement.
 - c. LPL shall neither be in nor have an attorney-client relationship with the Independent Reviewer, and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the Independent Reviewer from transmitting any information, reports, or documents as set forth in this Order to the IPU or to LPL's Board of Directors.
 - d. LPL may request confidential treatment be afforded to any material provided by LPL and/or the Independent Reviewer to the IPU, and the IPU shall provide such treatment and seek to prevent public disclosure of those materials to the full extent possible under its laws.
 - e. LPL shall not have the authority to terminate the Independent Reviewer or any third-party service provider engaged in connection with the Historical Trade Review and related remediation, without prior written approval from the Lead States.

9. LPL shall offer to repurchase the securities where the securities are still held in an LPL Account (subject to a standardized repurchase formula) or to pay damages where the position has been sold (subject to a standardized damages formula) for each trade involving an unregistered, non-exempt equity or fixed income security. Each offer shall include interest at a rate of three (3) percent simple interest per annum. Interest shall be calculated from the trade date of the purchase to the earlier of May 1, 2018 or the date on which the customer sold the security, if applicable.
10. For customers with affected securities who have transferred their accounts away from LPL, LPL will attempt to contact the customer to determine whether the customer either (1) sold the position after transferring it away from LPL or (2) still holds the position at a broker-dealer other than LPL. If the customer still holds the position, LPL will also need to determine whether it is feasible for the securities to be transferred back to LPL for purposes of LPL's offering to repurchase the securities. If the customer fails to timely provide information necessary for LPL to make a repurchase or damages offer using the formula described in Section III(B)(9) above or if it is not feasible to transfer the securities back to LPL for repurchase, then LPL will make a damages offer to the customer based on a revised formula. The damages shall be calculated by deducting the lowest reasonably identifiable value of the security on the date of transfer from the amount paid and applicable interest.
11. LPL shall memorialize each offer in a letter (each, an "Offer Letter"), pursuant to the following terms:
 - a. LPL and the Lead States will work to design a template Offer Letter (providing recommended format and the categories of information to be included with every offer). The Lead States will distribute the final template Offer Letter to the Jurisdictions.
 - b. If the IPU requires modification of the final template Offer Letter, the IPU must communicate that requirement, or advise LPL when the IPU will communicate the details of that requirement, to counsel for LPL within ten (10) business days of receipt of the final template Offer Letter. LPL shall work in good faith to address any questions or concerns raised by the IPU and to comply with any statutory or regulatory requirement in Delaware related to the form or content of such Offer

Letters. Absent contact from the IPU within ten (10) business days, LPL may presume that the IPU has approved the template Offer Letter, inclusive of any waiver or release language, for distribution to offerees in Delaware.

- c. Each Offer Letter shall be delivered to the offeree's last known mailing address as maintained in LPL's records in a manner that enables confirmation of delivery (*e.g.*, certified U.S. Post Mail or Federal Express). For offerees that have elected, in writing, to receive correspondence electronically, Offer Letters may be sent electronically, so long as electronic delivery includes a mechanism to confirm that the Offer Letter was delivered (*e.g.*, request for read receipt).
 - d. Each Offer Letter shall clearly state the terms of the offer, and shall provide in bold underlined font: (1) the steps required to accept the offer, (2) the deadline for acceptance, and (3) the contact information at LPL whereby the offeree can obtain additional information.
 - e. LPL may include within its Offer Letters a waiver or release relative to the transactions it is offering to remediate. Notwithstanding any such waiver or release, neither the Historical Trade Review nor the Repurchase Program (defined below) shall operate to extinguish or preclude any individual claim or private right of action based on sales practice violations (*e.g.*, material misrepresentation or omission, or suitability) that is otherwise available to any offeree, except to the extent that such claim or right of action is based primarily on the unregistered, non-exempt status of the security or transaction which LPL is offering to remediate. In any event, the form and content of any such waiver or release shall not be unacceptable to the IPU.
12. The Offer Letter shall remain open for a period of sixty (60) days from the date it is sent to the offeree.
- a. Within sixty (60) days of the date that Offer Letters are sent, LPL shall provide the IPU a list of offerees in Delaware for whom Offer Letters were returned as undeliverable so that the Jurisdiction may attempt to locate those offerees.
 - i. If the IPU elects to try to locate current addresses for this population of offerees, then it shall inform LPL or its representative. The IPU will then have